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Supreme Court, U.S.
FILED

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No. _____

IN THE
Supreme Court of the United States

JOBST W.F. BLACHY, et al.,
Cross-petitioners,

v.

ROSEMARY C. BUTCHER, et al.,
Respondents.

On Petition For Writ of Certiorari
to The United States Court of Appeals
For The Sixth Circuit

CONDITIONAL CROSS-PETITION FOR WRIT OF CERTIORARI

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February 15, 2001

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QUESTION PRESENTED

May the lien of the Internal Revenue Service for taxes unpaid by Alexander and Rosemary Butcher be satisfied by sale of the property owned by cross-petitioners and held in constructive trust by the Butchers, when the Butchers have been judicially determined to own only bare legal title and no beneficial interest?

PARTIES

This is a conditional cross-petition. The opening petition is docketed as No. 00-1155. The cross petitioners are all respondents to the opening petition other than the United States:

Jobst W.F. Blachy; Lynn A. Blachy; Davida Gale; Peter E. Boss; Jeanette A. Boss; Kenneth W. Gitlin; Roslyn E. Gitlin; Joseph H. Jones; Barbara Ann Jones; T.F.C. Agency, Incorporated, a Michigan Corporation; George F. Malley; Barbara C. Malley; Richard A. Monash; Carol Monash; Charlotte R. Monash; E. Jerome McCarthy; Gunther S. Meisse; Jeanne R. Meisse; Irving Shanbom; Patricia Shanbom; Ronald W. Mitchell; Patricia W. Mitchell; Anthony J. D'Errico; Ann T. D'Errico; Northwestern Savings and Loan Association; Lawyers Title Insurance Corporation; Thomas G. Allshouse; Sheryle K. Allshouse; and First Nationwide Bank.

Respondent Lawyers Title Insurance Corporation is a principal subsidiary of a publicly owned corporation, LandAmerica Financial Group, Inc. No other respondent corporation has either a publicly owned parent or nonwholly owned subsidiary company.

Respondents to this cross-petition are Petitioners in the Opening Petition and the United States. The Petitioners in the Opening Petition are:

Robert E. Butcher and Rosemary C. Butcher, co-personal representatives of the estate of Alexander M. Butcher, deceased; Rosemary C. Butcher, an individual; Little Traverse Development Company, a Michigan Corporation, and H.C. Development Company, a Michigan Corporation. The corporate entities, Little Traverse Development Company and H.C. Development Company have no parent companies or nonwholly owned subsidiaries.

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Sixth Circuit is reported at 22 F.3d 896 (6th Cir. 2000). It is appended to the opening petition at App. 1a. The Opinion of the District Court for the Western District of Michigan is reported at 35 F. Supp. 2d 554 (W.D. Mich. 1999). It is appended to the opening petition at App. 43a.

JURISDICTION

The Court of Appeals' Opinion was issued July 21, 2000. The Court of Appeals denied petitions for rehearing and suggestions of rehearing *en banc* filed by petitioners and cross-petitioners. This conditional cross-petition is filed within thirty days following the docketing of the opening petition. Jurisdiction is invoked pursuant to 28 U.S.C. 1254.

STATUTES INVOLVED

Bankruptcy Code — Property of the Estate

11 U.S.C. 541(d):

> Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

Internal Revenue Code —

Property of Delinquent Taxpayer

26 U.S.C. 6321:

> If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

STATEMENT OF THE CASE

Cross-petitioners joined the United States Internal Revenue Service as defendant in this action because the IRS had asserted a lien for unpaid taxes on the properties involved in this case. The IRS claimed the right to collect from the properties taxes owed by Alexander and Rosemary Butcher. The District Court ruled that the constructive trust interests of cross-petitioners defeated the IRS lien because, under Michigan law, "a trustee of a constructive trust holds bare legal title to the property that is subject to the trust for the benefit of the beneficiary." Opening Petition App. 79a.

The Court of Appeals reversed that ruling, holding that the constructive trust did not arise until the District Court's adjudication, after attachment of the IRS lien. Moreover, the Court of Appeals ruled that equity favored the IRS. Opening Petition App. 13a-17a.

Circuit Judge Eugene E. Siler, Jr., dissented from that ruling, on the ground that "the IRS had no better rights than did the Butcher family." Opening Petition App. 31a.

REASONS FOR GRANTING WRIT

This is a conditional cross-petition under Supreme Court Rule 12.5. Cross-petitioners are all respondents to the Petition other than the United States. Cross-petition-

ers were content to abide the decision of the Court of Appeals. If, however, this Court issues a writ of *certiorari* to the Court of Appeals, cross-petitioners pray that the writ include the issue raised by this cross-petition.

The Sixth Circuit Court of Appeals' decision on the IRS lien conflicts with authoritative decisions of other United States Courts of Appeals that have addressed the issue presented. The Court of Appeals properly affirmed the district court's finding that the Butcher defendants held the subject property in constructive trust for the cross-petitioning condominium owners. That finding was based upon the Butchers' misleading and deceptive conduct that took place beginning in 1978. Beginning in 1981, the Butchers' companies conveyed the condominiums to the cross-petitioners. In holding that the cross-petitioners' ownership interest was subject to a 1988 IRS tax lien, the Court of Appeals misapprehended the nature of a constructive trust. Under Michigan property law, a constructive trust arises upon the wrongful conduct of a party and immediately defines the wrongdoer's interest in the property. In this case, the Butchers were constructive trustees. They had no ownership interest, no equitable interest, to which the 1988 tax lien could attach. The Court of Appeals' finding that the property was subject to a constructive trust cannot be reconciled with the Court of Appeals' finding that the IRS tax lien attached to the property, as a matter of Michigan property law.

A. Under Michigan Law, A Constructive Trust Arose Upon The Wrongful Conduct of The Butchers, Immediately Stripping The Butchers' Equitable Interest In The Property.

The Court of Appeals recognized in its opinion the well-established principle that, when the federal government asserts a tax lien against a taxpayer's property, an initial inquiry must be made concerning the taxpayer's rights in the subject property. *See* Opinion, Opening Petition App 13a. This threshold question about property rights

must be determined under state law, *Aquilino* v. *United States*, 363 U.S. 509, 512, 80 S. Ct. 1277 (1960). **After the taxpayer's interest in the property is ascertained**, federal law controls whether and to what extent a tax lien may attach to that interest.

Although the Court of Appeals initially noted this two-step inquiry, it failed to adhere to it. Rather, the Court of Appeals summarily concluded that under Michigan law, a constructive trust does not arise until a judicial decision imposes such a trust. *See* Opening Petition App.14a. The Court of Appeals then engaged in a "priority of competing claims" analysis under federal law, without fully or consistently respecting the Butchers' limited interest in the property under Michigan law. Finally, the Court of Appeals engaged in weighing the "equities" between the IRS and cross-petitioners. *Id.* at 16a-17a. The equities have nothing to do with it. This is an issue of federal and state law.[1]

Michigan courts have consistently held that the events giving rise to a constructive trust cause a split in the title of the subject property, immediately altering the nature of the wrongdoer's interest in the property. The wrongdoer holds only one of two independent titles to the property, legal title, while equitable title is vested in the party wronged. *See Stephenson* v. *Golden*, 279 Mich. 710, 746, 276 N.W. 849 (1937). Based upon this division of title, Michigan courts have imposed upon the holders of property impressed with a constructive trust a duty to account for and pay over any rents or profits derived from the property prior to enforcement of the trust. *See Nichols* v. *Martin*, 277 Mich. 305, 269 N.W. 183 (1936).

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[1] Even if equity was involved in deciding whether the IRS should be able to satisfy the Butchers' debts out of cross-petitioners' property, Circuit Judge Siler correctly observed that "I would not find that [the IRS] is more faultless than the condominium owners, who relied upon legal opinions that they had proper title." Opening Petition App. 31a. Nor does it seem equitable to pay the Butchers' taxes with the condominiums cross-petitioners bought and paid for.

The requirement to pay rents and profits derived from the property prior to judicial enforcement recognized in *Nichols* cannot be reconciled with the Court of Appeals' conclusion that a constructive trust does not arise until a judicial decision imposes such a trust. The nature of the interest in property is altered upon the wrongful conduct; the judicial enforcement of the property rights has the practical effect of reunifying legal and beneficial title, which would not be necessary had the interests not been separated prior to the court's declaration.

The Michigan Supreme Court recognized that a constructive trust alters the nature of interests in property from the very moment the property was wrongfully acquired in *Fidelity & Deposit Co.* v. *Stordahl*, 353 Mich. 354, 91 N.W.2d 533 (1958). In that case, a husband and wife purchased property together. The wife used her own honestly acquired money and the husband used money embezzled from his employer. The court held that the husband's purchase of property with embezzled funds immediately gave the husband an interest in the property as trustee for his employer. Since his interest was "distinct" from that of his wife, the two could not have acquired the property as tenants by the entireties. *Id.* at 361. *Stordahl* demonstrates that under Michigan law, a person who wrongfully acquires property obtains a different interest in the property, not ownership. *Stordahl* clearly demonstrates that conduct giving rise to a constructive trust has an immediate effect on the wrongdoer's property rights.

In its opinion, the Court of Appeals cites *Soo Sand & Gravel Co.* v. *M. Sullivan Dredging Co.*, 259 Mich. 489; 244 N.W. 138, 140 (1932), for the proposition that "a constructive trust is strictly not a trust at all, but merely a remedy administered in certain fraudulent breaches of trust." Although the court in *Soo Sand & Gravel* referred to a constructive trust as a "remedy," it did **not** conclude that a constructive trust arises only upon judicial determination under Michigan law. In fact, *Soo Sand & Gravel*

supports the cross-petitioners' contention that the events giving rise to a constructive trust immediately alter the nature of a wrongdoer's rights in the property. The property at issue in *Soo Sand & Gravel* was owned by Lapish, a shareholder of the plaintiff corporation, who failed to designate the corporation as the title holder when purchasing the land on its behalf. The court held that even though Lapish held legal title to the property, the plaintiff corporation "at all times" had the absolute right to every substantial interest in the property. *Id.* at 494. Accordingly, the suit could continue in the corporation's name even though it did not hold legal title to the subject property at the time the lawsuit was filed. The bankruptcy court in *McTevia* v. *Adamo* (In re Atlantic Mortgage Corp.), 69 B.R. 321, 330 (Bankr. E.D. Mich. 1987), relied upon *Soo Sand & Gravel* when it ruled under Michigan law that "a constructive trust arises when the events which result in the constructive trust occur."

The Court of Appeals also relied on *United States* v. *Dishman Independent Oil, Inc.*, 46 F.3d 523, 526 (6th Cir. 1995), for the proposition that the priority of a federal tax lien against competing claims is governed by federal law. The Court of Appeals engaged in a "priority of competing claims" analysis under federal law, and held that only claims that meet the federal standard of "choateness" before the federal tax lien arises have priority over the federal tax lien. According to the Court of Appeals, the cross-petitioners' claims were inchoate when the IRS tax lien was filed, and were therefore subordinate to the IRS lien. *Dishman's* holding that federal law controls questions of the priority of federal tax liens is not applicable in this case because there are no "competing liens" at issue here. *Dishman* concerned the priority of a creditor's state prejudgment attachment lien on a debtor's personal property compared to a federal tax lien that attached before judgment was entered for the creditor. Here, the condominium owners' claim was not a

competing lien claim, choate or otherwise. Rather, it was a claim of ownership, correctly resolved under Michigan law. Once it was resolved that the Butchers had no rights to the condominiums, federal law dictated that there was no "property" or "rights to property" to which an IRS lien could attach. *See Aquilino*, *supra*. Accordingly, the federal law principles of priority espoused in *Dishman* are not applicable here.

In reversing the district court, the Court of Appeals noted three cases from other circuits that considered whether a tax lien could attach to property subsequently adjudicated to be held in constructive trust. All three cases resolved the issue in favor of the constructive trust beneficiary. *See* Opening Petition App. 15a-16a (citing *FTC* v. *Crittenden*, 823 F. Supp. 699 (C.D. Cal. 1993), *aff'd*, 19 F. 3d 26 (9th Cir. 1994), *Reliance Ins. Co.* v. *Brown*, 40 B.R. 214 (W.D. Mo. 1984), *TMG II* v. *United States*, 778 F. Supp. 37 (D.D.C. 1991), *aff'd in part and rev'd in part*, 1 F.3d 36 (D.C. Cir. 1993)). The Court of Appeals found the cases were unpersuasive "because they fail to explain how a constructive trust that is judicially imposed after the filing of a federal tax lien can retroactively meet the federal standard of choateness, thus priming the lien." Opening Petition App. 16a.

The reason those cases did not address the issue of choateness was that, as in the case at hand, the inquiry is inapposite; constructive trust cases simply do not involve competing claims of lien priority. In those cases the properties allegedly subject to IRS tax liens did not belong to the delinquent taxpayers. In *Crittenden*, *supra*, the court held that a constructive trust arises at the time of the wrongful act and defeats a tax lien that arises after the wrongful act but before the court has ruled that the property is subject to constructive trust. The court refused to consider issues of priority under federal law, and the related concept of choateness, because it found that a constructive trust existed under California law, and thus the tax lien could not attach to the property.

Similarly, in *TMG II*, *supra* at 46, the IRS conceded that "tax liens do not attach to properties subject to a constructive trust because, while the taxpayer may have legal title, the constructive trust gives its beneficiary equitable title."

Moreover, a number of federal cases not mentioned in the Court of Appeals' opinion have held that an IRS tax lien does not attach to property held in constructive trust. In *United States* v. *Fontana*, 528 F. Supp. 137 (S.D.N.Y. 1981), the government argued that a constructive trust does not exist until it is imposed by a court because it is merely a remedy. The court disagreed and noted that the IRS could not seize property that did not belong to the taxpayer. *See also*, *Schwarz* v. *United States*, 191 F.2d 618 (4th Cir. 1951); *Dennis* v. *United States*, 372 F.Supp. 563, 568 n.1 (E.D. Va. 1974) ("Money held in trust, whether constructive or actual, cannot be said to 'belong' to the trustee").

In short, wrongful acts immediately alter the nature of the wrongdoer's interest in the property. Thenceforth, the property is held in constructive trust. Courts take time to adjudicate these rights but the rights exist while that necessary process proceeds. The Court of Appeals could look only to Michigan law in defining the Butchers' interests in the property. Federal principles of priority are irrelevant because there are no competing claims in this case.

B. The Holding Of The Court of Appeals *In re Omegas*, That A Constructive Trust Does Not Arise Until Judicial Declaration, Is Contradicted By The Legislative History Of § 541(d) Of The Bankruptcy Code And Has Been Rejected As Wrongly Decided By The Majority Of Federal Courts To Consider It.

The Court of Appeals relied on *In re Omegas Group*, 16 F.3d 1443 (6th Cir. 1994) by analogy, based upon its premise that "because a constructive trust, unlike an

express trust, is a remedy, it does not exist until a plaintiff obtains a judicial decision finding him to be entitled to a judgment 'impressing' defendant's property or assets with a constructive trust." Opening Petition App. 15a. The holding in *Omegas* was based upon an erroneous interpretation of 11 U.S.C. § 541(d) (Bankruptcy Code). Here, the IRS lien is based upon 26 U.S.C. § 6321 (Internal Revenue Code), which, according to the Supreme Court in *Aquilino*, *supra*, defers to state law for determination of the nature and extent of a taxpayer's property interests. Thus, the Court of Appeals was required to look to Michigan law to determine the nature of the Butchers' interest in the subject property, and *Omegas* is wholly irrelevant to that determination.

More importantly, the holding in *Omegas* not only conflicts with Michigan law, but it is at odds with the legislative history of § 541(d) of the Bankruptcy Code and has been rejected by the majority of federal courts and commentators to consider it.

1. *In Re Omegas* Conflicts With The Legislative History of § 541(d) Of The Bankruptcy Code.

In *Omegas*, the Sixth Circuit held that a constructive trust is remedial and, unless such a trust has been judicially declared before bankruptcy, it does not trump the estate's interests. *Omegas*, *supra*, at 1449. The Court stated, "[n]owhere in the Bankruptcy Code does it say, 'property held by the debtor subject to a constructive trust is excluded from the debtor's estate.' " *Id.* at 1448. In so holding, the court insisted that a debtor's property be ratably distributed among creditors under the Bankruptcy Code's scheme of priority and not by means of state law constructive trust.

However, section 541(d) of the Bankruptcy Code establishes that the Code will not ratably distribute among a debtor's creditors property that belongs to third parties. Thus, § 541(d) recognizes that property claimed by the estate may in fact be subject to superior rights,

including property held in constructive trust. Legislative history to § 541(d), which the *Omegas* court did not consider, provides that:

> "Situations occasionally arise where property ostensibly belonging to the debtor will actually not be property of the debtor, but will be held in trust for another. For example, if the debtor has incurred medical bills that were covered by insurance, and the insurance company had sent the payment of the bills to the debtor before the debtor had paid the bill for which the payment was reimbursement, *the payment would actually be held in a constructive trust for the person to whom the bill was owed.*" (emphasis added)

H.R.Rep. No. 595, 95th Cong., 1st Sess., at 368 (1977); S.Rep. No. 989, 95th Cong., 2d Sess., at 82 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5868, 6324.

Thus, Congress clearly intended that § 541(d) of the Bankruptcy Code would not encompass property a debtor holds subject to a constructive trust. This court's holding to the contrary in *Omegas* directly conflicts with Congress's intent.

2. A Number Of Federal Courts Have Rejected *Omegas* As Wrongly Decided.

Federal courts in several circuits have taken issue with the holding in *Omegas*. In *Mullins* v. *Burtch* (*In re Paul J. Paradise & Associates*), 249 B.R. 360 (D. Del. 2000), Rodman Mullins filed an adversary proceeding seeking a judicial determination of ownership of a parcel of real estate identified as Lot 33. Mullins had transferred title of Lot 33 to the debtor in exchange for a note executed in his favor by the debtor. The debtor filed a bankruptcy petition without paying Mullins, and title to Lot 33 remained in the debtor's name. The bankruptcy court held that, as a matter of law, even if an equitable trust could be imposed on Lot 33 in Mullins' favor, the property was subject to the trustee's strong arm powers under

§ 544(a)(3) and, therefore, was part of the debtor's estate. On appeal, the federal district court affirmed the result reached in the bankruptcy court, but found that it was error for the lower court to have relied on the *Omegas* proposition that constructive trusts do not arise until judicially declared, "or that, as a general rule, the policy of ratable distribution necessarily trumps state equitable trust law***". *Id.* at 371. The court further observed that "the Sixth Circuit Court of Appeals' blanket statement in *Omegas*, that constructive trusts come into existence" upon judicial declaration, was "made without citation to any case authority, runs counter to the teaching of the Third Circuit and Supreme Court law, that courts must look to state law to determine whether and when constructive trusts attach in bankruptcy law." *Id.* at 370-71.

In *Skilled Nursing Professional Services* v. *Sacred Heart Hosp. (In re Sacred Heart Hosp.)*, 175 B.R. 543 (Bankr. E.D. Pa. 1994), the court criticized *Omegas* for "seem[ing] to announce a federal rule of general applicability prohibiting a bankruptcy court from ever imposing a constructive trust under applicable state law post-petition." *Id.* at 554, n7. The court noted § 541(d)'s legislative history and noted that, under Pennsylvania law, a constructive trust arises contemporaneously with the equitable duty to convey the property to another rather than upon judicial recognition.

In *Old Republic Nat'l Title Ins. Co.* v. *Tyler (In re Dameron)*, 206 B.R. 394 (Bankr. E.D. Va. 1997), *aff'd*, 155 F.3d 718 (4th Cir. 1998), creditors brought an adversary proceeding against several debtors to recover escrowed loan funds held in the debtors' bank account, because the debtors had misappropriated the loan funds by failing to disburse the funds pursuant to the lenders' closing instructions. The court held that, under Virginia law, the debtors took the funds "impressed with constructive trusts" and the funds could, therefore, be excluded from the estate under § 541(d). The *Dameron*

court criticized *Omegas* for "cit[ing] no case authority for its initial conclusion that a constructive trust arises only upon a judicial determination***" *Id.* at 399. The *Dameron* court noted that "Professor Sherwin, whose law review article *Omegas* relied so heavily upon, asserts that the 'time of creation' of a constructive trust 'is a false issue that should not enter into the courts' analyses.' " *Id.* at 400.

In *Clark* v. *Wetherill (In re Leitner)*, 236 B.R. 420, 423 (Bankr. D. Kan. 1999), Wetherill hired Leitner to perform accounting and legal services for his company. Leitner embezzled funds from the company and used the funds to purchase a home. Wetherill later discovered the fraud and sued Leitner, claiming Leitner's fraud created a constructive trust. The court anticipated Kansas would follow the majority rule that a constructive trust arises simultaneously with "the duty to reconvey the property, not at the date of final judgment declaring the trust as *Omegas* held." *Id.* at 424.

In re Reider, 177 B.R. 412 (Bankr. D. Me. 1994), the court held that the beneficiary of a constructive trust had rights superior to those of the trustee. Addressing *Omegas'* contrary conclusion, the court stated, "*Omegas* goes too far. Properly applied, constructive trust theory does not conflict with the Code's distribution scheme. Section 541(d) establishes that the Code will not ratably distribute among a debtor's creditors property that belongs to third parties." *Id.* at 415.

Andrew Kull, reporter for the Restatement of Restitution, echoed these courts' criticisms when he wrote that "[t]he Sixth Circuit's announcement that constructive trust was 'anathema to the equities of bankruptcy' contradicted a century of bankruptcy law, including Supreme Court authority, legislative history, and the standard commentary." Restitution In Bankruptcy: Reclamation And Constructive Trust, 72 Am. Bankr. L.J. 265, 272 (1998). As for *Omegas'* holding that a constructive trust is only effective upon judicial determination, Kull

noted that the notion was "impossible to square with our basic notions of property," because "ownership is not ordinarily destroyed when property is transferred by mistake ***". *Id.* at 276. Moreover, according to Kull, "the usual precept is that bankruptcy respects state-law property rights except where they have been specifically reallocated." *Id.*

Here, the Court of Appeals' citation to and reliance upon *Omegas* in its opinion is troubling for two reasons. First, the Court of Appeals was required to look to Michigan law to determine the nature of the Butchers' interest in the subject property to determine whether a tax lien could attach to it. *Omegas'* holding on when a constructive trust arises for purposes of federal law is an inappropriate inquiry. Second, the foundation upon which *Omegas* stands is weak. Its holding conflicts with the express language of the legislative history of § 541(d) of the Bankruptcy Code, and many courts have expressly rejected it. For these reasons, this Court should overrule *Omegas* as wrongly decided.

C. The Equities In This Case Favor The Condominium Owners, Not The IRS.

The Court of Appeals further justified upholding the IRS tax lien in this case because "it would be unfair to the IRS, a party without 'fault,' to prime the IRS's choate tax lien by retroactively applying a constructive trust in favor of the plaintiffs." The Court of Appeals apparently found Lawyers Title was at "fault" for failing to discover the July 12, 1978 conveyance back to the Butchers. The Court of Appeals did not provide any citation to the record.

While a court certainly has wide flexibility in fashioning equitable remedies, the Court of Appeals' ruling penalizes the only parties to this suit truly without 'fault', the condominium owners. As Judge Siler noted in dissent, the IRS cannot claim to be an 'innocent' lienholder, because it had notice at the time it filed its lien that the

condominium owners had claimed interests in the property. First, recorded deeds from the Butchers' development companies to the condominium purchasers gave notice that the purchasers claimed title to the property. Second, simple inspection of the property would have revealed that the condominium owners were in possession.[2] Dissent, Opening Petition App. 31a Notwithstanding this notice to the IRS, under the Court of Appeals' decree, the condominium owners now must suffer the imposition of a tax lien on their property. Such a decree gives the IRS a greater interest in the property than the Butchers had. That result is contrary to the holding in *United States* v. *Rogers*, 461 U.S. 677, 103 S. Ct. 2132 (1983), that once the taxpayer's interest is defined, the government's right rises no higher than those of the taxpayer. The Court of Appeal's holding is also at odds with Michigan constructive trust law, as expressed in *Fidelity of Deposit Co.* v. *Stordahl*, *supra*. In *Stordahl*, even an innocent wife was a tenant in common, not a tenant by the entireties, because her husband's embezzlement impressed a constructive trust upon his interest in the real property they purchased together. Here, the United States' lien, even if "innocent," cannot improve the Butchers' interest. They were trustees *ab initio* as a result of their wrongdoing.

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[2] "Open, manifest and unequivocal possession of premises constitutes constructive notice of the rights of one in such possession as effectively as compliance with the recording law." *Kastle* v. *Clemons*, 330 Mich. 28, 31, 46 N.W.2d 450, 451 (1951).

CONCLUSION

If a writ of *certiorari* is issued upon the opening petition, then this conditional cross-petition should be granted also. Should the Supreme Court entertain this case, cross-petitioners pray that the Court reverse that portion of the Court of Appeals opinion subjecting the condominium owners' property to the IRS tax lien. This Court should affirm the district court's decision in all respects. Additionally, this Court should overrule *Omegas*.

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(2)

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In the
Supreme Court of the United States

JOBST W.F. BLACHY, et al.,
Cross-Petitioners,

v.

ROSEMARY C. BUTCHER, et al.,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

PETITIONERS' BRIEF IN OPPOSITION TO CROSS-PETITIONERS' CONDITIONAL CROSS-PETITION FOR WRIT OF CERTIORARI

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ARGUMENT

Respondents/Petitioners oppose the granting of Cross-Petitioners' (except the United States) Conditional Cross-Petition for Writ of Certiorari for the following reasons:

1. **The purchase agreements, and, the deeds from Little Traverse Development Company (LTDC) and/or H.C. Development Company (HCDC) (the development corporations) to insured Plaintiffs were admittedly void under the allegations of the Complaint, giving rise to no cause of action, except reimbursement of the "purchase" moneys. Paragraphs 46, 56, and 93 of the Complaint read:**

> 46. At the time it conveyed title to Plaintiffs or their predecessors by virtue of a warranty deed, Little Traverse Development Co. was not seized with record title to the various condominium units, nor did it have the right to convey or give quiet possession.
>
> 56. At the time it conveyed title to Plaintiffs or their predecessor by virtue of a warranty deed, H.C. Development Co. was not seized with record title to the various condominium units, nor did it have the right to convey or give quiet possession.

> 93. Neither Little Traverse Development Co. nor H.C. Development Co. had marketable title to the units or "the land" at the time they sold condominium units to Plaintiffs or their predecessors.

The purchase agreements and the warranty deeds executed by the development corporations were each void because they were not signed by the true owners of the property described therein. (MCL 566.106.) All of the lower courts agreed with Plaintiffs that the purchase agreements and warranty deeds were void, which is why the insured Plaintiffs were seeking imposition of a constructive trust.

A void contract cannot create any legal or equitable rights in the parties. In *Scott v. Bush,* 26 Mich. 418, 420 (1873), the Court stated:

> "We have held in . . . that a contract void under the statute of frauds, is a mere nullity, and cannot be used for any purpose whatever. And we cannot conceive of such a thing as a contract which cannot be enforced as a contract, and yet can be the foundation of legal obligations arising out of nothing else."

Plaintiffs have no cause of action except for restitution from LTDC and/or HCDC. For more than 100 years, the law in Michigan has been that:

> "The contract set out, being void under the Statute of Frauds, cannot be used as the foundation **of any legal or equitable rights**. If the party pays money under such a void

> contract he may recover it back in assumpsit. (Emphasis Supplied). *Kelly v. Kelly,* 54 Mich. 30, 48 (1884). See also *Thorbahn v. Walker's Estate,* 269 Mich. 586 (1934).

Cross-Petitioners argue (Cross-Petitioners' Brief, p. 4) that, despite the fact that the purchase agreements and deeds were concededly void, that:

> Because the Butchers' acts were wrongful, they had no valid interest in the properties. The condominium owners did not hold a "lien" on the Butchers' title. They owned the property -- bought and paid for. The Butchers had no lawful interest on which to impose a "lien." They owned nothing.

In addition, Cross-Petitioners claim that these void contracts and deeds gave them a cause of action against the United States, in an amount exceeding $100,000, all because they paid moneys to the development corporations. Payment of moneys to a non-owner development corporation, or to any other non-owner entity, could never take the void agreements out of the Statute of Frauds.

The holding in *Kelly v. Kelly, supra*, at page 48, that:

> "The contract set out, being void under the Statute of Frauds, cannot be used as the foundation **of any legal or equitable right.**"

cannot possibly be reconciled with the holdings of the lower courts that the payment of moneys under void purchase agreements, resulting from the negligent record title searches by Lawyers Title, somehow gives rise to an equitable action

against property owned by persons not party to the void contracts.

Respondents/Petitioners mean no disrespect to the lower courts but, using the vernacular, what part of the *Kelly v. Kelly* quoted statement do they not understand? *Kelly* has stood as Michigan law for 115 years and is not likely to be changed anytime soon.

The action is an action on the void purchase agreements (Respondents'/Petitioners' App. 3a-6a); the claimed injury (Respondents'/Petitioners' App. 24a, 64a) is "defective title." The "purchasers" are entitled to recover their money from the "sellers," but there is no Michigan law or Supreme Court decision which remotely suggests that void agreements can give rise to an action against real property owned by others, or, that contracts void under Michigan law can in any way adversely affect a valid United States lien against real property located in Michigan.

MCL 566.106 reads:

> "Section 6. No estate or interest in lands, other than leases for a term not exceeding 1 year, nor any trust or power over or concerning lands, or in any manner relating thereto, shall hereafter be created, granted, assigned, surrendered or declared, unless by act or operation of law, or by a deed or conveyance in writing, subscribed by the party creating, granting, assigning, surrendering or declaring the same, or by some person thereunto by him lawfully authorized by writing."

A claim arising out of a void agreement does not create an interest in real property by operation of law.

The district judge (Respondents'/Petitioners' App. 48a) apparently held that the deeds to the insured Plaintiffs were valid because they "were signed by LTDC and HCDC, from whom Plaintiffs purchased the property." If this is a correct interpretation of Michigan law, then the constructive trust proceedings and declaration were entirely unnecessary. There is no Michigan statute or appellate case which could validate the deeds from the corporations. There is no claim that the corporations were authorized in writing to sign the deeds on behalf of Alexander or Rosemary.

The 6th Circuit panel disposed of Petitioners' arguments (Respondents'/Petitioners' Brief, pp.27-28) that the deeds from the corporations were void under the Statute of Frauds as "totally without merit" (Respondents'/Petitioners' App. 29a), without further explanation.

2. The District Court had no subject matter jurisdiction over the action because the priority claims over the government tax liens were not ripe. Fed. R. Civ. P. 12(h)(3) provides:

> (3) Whenever it appears by suggestion of the parties or otherwise that the court lacks jurisdiction of the subject matter, the court shall dismiss the action.

Cross-Petitioners' pleaded claim against Respondents/Petitioners is that they are entitled to the relief of imposition of a constructive trust, or, in the alternative,

damages, against or from one or more of the Petitioners. No federal question is involved in the constructive trust count or in any of the other eight counts of the Complaint. Cross-Petitioners' pleaded claim against the Internal Revenue Service (IRS) is that, **if Cross-Petitioners obtain constructive trust relief**, they are entitled to priority over the IRS joint tax liens, as to Alexander's interest in the 17.83 acres at issue. They make no claim of entitlement to priority should they not obtain constructive trust relief.

The validity of the IRS joint tax liens is not challenged by Cross-Petitioners. Both they and the United States have filed claims against the entireties property in Rosemary's Bankruptcy case. 28 U.S.C. § 1334(e) provides:

> "(e) The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction of all of the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate."

Surely, the Eastern District Bankruptcy Court, and not the Western District Court, has exclusive jurisdiction over the entireties property and Rosemary's right of survivorship.

The proper (and exclusive) forum for resolving a dispute between claimants as to property listed in a bankruptcy estate is the Bankruptcy Court. The 6th Circuit Court held (Respondents'/Petitioners' App. 17a) that there was no doubt that Rosemary's entireties interest in the 17.83 acres became part of her bankruptcy estate upon filing, so, Cross-Petitioners are arguing that Alexander's entireties "interest" **is not** subject to the **joint liens**, but that Rosemary's entireties "interest" **is** subject to the joint liens.

Neither the IRS nor the United States are necessary or proper parties to the constructive trust action. No petitioner is a necessary party to the priority action against the IRS, but Cross-Petitioners cannot assert priority over the IRS liens until they first obtain a judicial determination that they are constructive trust beneficiaries as of a particular date. Since the Bankruptcy Court was held not to have the power to impose a constructive trust in *Re: Omegas Group,* 16 F.3d 1443 (6th Cir. 1994), venue of the constructive trust claim should have been transferred back to the state court for determination.

The holding by the 6th Circuit (Respondents'/Petitioners' App. 22a-23a) that "the bankruptcy court can share its jurisdiction" on the constructive trust claim is puzzling. If the Eastern District Bankruptcy Court had no power to impose a constructive trust, then the Western District Court could not, through a change of venue, acquire jurisdiction to impose a constructive trust by "sharing" the Eastern District Court's non-existent power. The two district courts have exactly the same authority.

In any event, there was no Federal Court jurisdiction over the matter because, on October 16, 1991, the suit filing date, the priority claim was not ripe. The void deeds did not create a cause of action against the government or against Alexander. In *Texas v. United States,* 118 S.Ct. 1257, 1259 (1998), this Court stated:

> "A claim is not ripe for adjudication if it rests upon "contingent future events that may not occur as anticipated or indeed may not occur at all" *Thomas v. Union Carbide Agricultural Products Co.,* 473 U.S. 568, 581, 105 S.Ct. 3325, 3333, 87 L.Ed.2d 409 (1985) (quoting

> 13A Charles A. Wright, Arthur R. Miller & Edward H. Cooper, Federal Practice and Procedure Sec 3532 p 112 (1984))."

The holding of the 6th Circuit is that it was Rosemary's bankruptcy filing on March 1, 1991, which divided or separated the entireties interest of the couple into two interests. On the prepetition lien filing dates and on the prepetition "sales" dates, the real property was unquestionably, immediately before each event, held by Alexander and Rosemary as tenants by the entireties.

But for the Chapter 7 filing, under the 6th Circuit's ruling, Plaintiffs below could not have acquired a constructive trust against Alexander's interest. *See Craft v. United States (Craft I)*, 140 F.3d 638, (6th Cir. 1998), *affirmed by Craft v. United States (Craft II)*, 233 F.3d 358 (6th Cir. 2000).

Cross-Petitioners sought a constructive trust only over Alexander's interest. Under the 6th Circuit's rulings, he had no individual prepetition interest over which a constructive trust could be imposed. Syllabus 9 of *Craft II* reads:

> "When state law provides that there can be no individual interest in property held in a tenancy by the entireties, there is nothing which can be deemed "property" or "rights to property" under the federal tax lien statute 26 USCA § 6321 ."

Nothing in this record would support Cross-Petitioners' argument that their priority claim against the United States relates back, based upon the filing and/or on postfiling events. They asserted only individual claims against Alexander's "interest."

The sole question presented to this Court by Cross-Petitioners supports Respondents'/Petitioners' argument. Cross-Petitioners ask:

> May the lien of the Internal Revenue Service for taxes unpaid by Alexander and Rosemary Butcher be satisfied by sale of the property owned by Cross-Petitioners and held in constructive trust by the Butchers, **when the Butchers have been judicially determined to own only bare legal title and no beneficial interest?** (Emphasis added).

Cross-Petitioners can make no legitimate claim of priority over a valid recorded joint federal tax lien until such time as they secure a final "judicially determined" judgment of entitlement against Alexander, individually, which they could not obtain during the entireties tenancy. Until then, there could be no possible federal court jurisdiction.

3. Cross-Petitioners' suit became moot when they failed to timely substitute a proper party for Alexander, after his death.

This issue is covered, as to Respondents/Petitioners, in their Argument 5. (Respondents/Petitioners Brief, p. 22.) In their Brief in Opposition (pp. 4-5), Cross-Petitioners drop all claims that they substituted a proper party for the deceased, and rely solely on the provisions of Fed. R. Civ. P. 25(c), which permits continuances of an action, in case of a transfer of interest, against the original party. Rule 25(c) does not purport to authorize continuance of an action against a decedent.

4. The District Court had no jurisdiction because the 17.83 acres were owned by Alexander and Rosemary by the entireties at the time of each claimed "sale" by the development corporations and were, therefore, exempt from execution on claims of parties who were not joint creditors of the couple.

No Cross-Petitioner claims to be a joint creditor of Alexander and Rosemary out of any unit "purchase" from LTDC or HCDC. The United States is admittedly a joint creditor of the couple. (Cross-Petitioners' Brief, p. 2.) The Conditional Cross-Petition brings the matter back full circle to October 16, 1991, the suit filing date. If the entireties property is exempt from claims of non-joint creditors under Michigan law, how can an individual claimed creditor obtain a cause of action against the entireties property by entering into a void contract with a corporation non-owner?

Just as the individual Cross-Petitioners, by this suit against Alexander's interest, seek priority over the joint liens of the IRS, they seek priority over the claims of all other bankruptcy court listed joint creditors, and they seek priority over Rosemary's claims to that portion of the property exempt under both state and bankruptcy law, despite centuries of legal decisions that individual (claimed) creditors of one entireties tenant cannot levy upon the property. (Respondents'/Petitioners' App. 18a.)

Cross-Petitioners seek to get around Michigan law, that "neither husband nor wife acting alone can alienate any interest in the property . . . ", and the Statute of Frauds, by claiming that something which Alexander supposedly said in

1978 gave rise to multiple constructive trusts in 1981-1987. The 6th Circuit held that it was Rosemary's Chapter 7 filing in 1991 which split and alienated the single entireties interest of the couple (Respondents'/Petitioners' App. 67a), not the prepetition unit "sales."

The District Court (Respondents'/Petitioners' App. 66a) and the 6th Circuit panel (Respondents'/Petitioners' App. 20a) each held that the entireties tenancy was terminated on October 30, 1991, so October 31, 1991 was the earliest date that any Cross-Petitioner could assert an individual claim against Rosemary and the property. At that point, Alexander's claimed creditors lost all possible chance of proceeding against the property.

11 U.S.C. § 522 (c) provides in pertinent part:

> "(c) Unless the case is dismissed, property exempted under this section is not liable during or after the case for any debt of the debtor that arose, or that is determined under section 502 of this title as if such debt had arisen, before the commencement of the case . . . "

On page 3 of the Cross-Petition, it is claimed:

> "Under Michigan property law, a constructive trust arises upon the wrongful conduct of a party and immediately defines the wrongdoer's interest in the property. In this case, the Butchers were constructive trustees. They had no ownership interest, no equitable interest, to which the 1988 tax lien could attach."

On page 4 of the Cross-Petition, Cross-Petitioners state:

> "Michigan courts have consistently held that the events giving rise to a constructive trust cause a split in the title of the subject property, immediately altering the nature of the wrongdoer's interest in the property. The wrongdoer holds only one of two independent titles to the property, legal title, while equitable title is vested in the party wronged."

Of course, these statements conflict with the holdings of both lower courts that a division of interests occurs upon the filing of a bankruptcy petition by one spouse; that the filing does not terminate the entireties' tenancy; and that Rosemary in fact had an interest, which "no doubt" (Respondents'/Petitioners' App. 17a) became part of her bankruptcy estate. Whatever Cross-Petitioners claim is against Rosemary, it most certainly "arose or was determined under Section 502" to have arisen before commencement of her case, and, neither lower court has held that the property which was listed in Rosemary's estate, is not exempt.

CONCLUSION

Cross-Petitioners claim entitlement to the condominium units, which 12 of them "bought and paid for" (Cross-Petitioners' Brief, p. 4), only they did not buy them from the owners of the units, and they did not pay their money to the owners of the property.

It is impossible, under Michigan law, to acquire any interest in real property out of warranty deeds not signed, as grantors, by both entireties tenants. The deeds and the purchase agreements are void.

There are no exceptions to the rule. None have been cited by Cross-Petitioners, or by the lower courts. The purchase agreements and deeds are void because they were not signed by the owners; any claim of an oral agreement is void because it is not in writing. Cross-Petitioners and the lower courts adamantly refuse to accept Michigan law on the point.

/s/_____
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